

Generally, sales of “canned” computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 130.1935(c). (This is a GIL.)

November 21, 2000

Dear Xxxxx:

This letter is in response to your letter dated November 2, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department’s website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

COMPANY is a tax compliance software company that is currently researching sales tax issues in an effort to supply our customers with complete and accurate sales tax information. The information we provide helps our customers’ maintain full tax compliance in your jurisdiction.

Attached is a worksheet listing products and services that we are currently researching for sales and use tax purposes. We would like to know if those products and services are subject to sales and/or use tax in your state.

In addition to telling us whether the items are subject to tax, please provide us with the citation in your jurisdiction’s statutes or other authoritative pronouncements to support the tax status of the items. If your state currently does not have any authoritative pronouncement for one or more of the items on our list, please indicate where we may write for a letter ruling.

In order to help clarify our request, we have attached a glossary of terms which should help in determining the definition of each item requested.

Please mail the completed worksheet in the enclosed self addressed, stamped envelope. If you have any questions, please do not hesitate to contact me at ####.

The following is a discussion regarding canned and custom computer software and software licenses. Generally, sales of “canned” computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 130.1935(c). Sales of software are taxable

regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

In regards to maintenance agreements, generally, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if

maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Assuming that the services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

In regards to Internet services, please note that Telecommunications Excise Tax may be applicable. The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. See 86 Ill. Adm. Code 495, enclosed.

Pursuant to Section 495.100(a), "gross charge" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money, whether paid in money or otherwise, including cash credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of material used, labor or service cost or any other expense whatsoever.

Generally, persons that provide subscribers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges which are used to obtain access to the Internet, are not considered to be telecommunications retailers. See 86 Ill. Adm. Code 495.100(d).

It is our general understanding that most Internet access providers do not, as part of their billing, charge customers for such line charges, but instead, pay to their telecommunications providers all transmission costs that they incur in providing the service. Generally, the customers pay to their providers all transmission costs that they incur while using the service. The single monthly fee charged by such retailers, which often represents a flat charge for a package of items including Internet access, E-mail, and electronic newsletters would generally not be subject to the Telecommunications Excise Tax.

However, please note that persons providing customers with the Internet access described above, but who also provide customers the use of 1-800 service, and separately assess customers with per minute charges for the use of such 1-800 numbers, are considered to be telecommunications retailers. Such retailers will incur Telecommunications Excise Tax on charges made for such 1-800 services. If, however, such Internet service providers do not separately assess customers with per minute charges, but pay their own providers for all transmission costs for the 1-800 service, they are not considered to be telecommunications retailers.

Subsection (c) of Section 2 of the Act defines "telecommunications," and states that this term does not include "value added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission." 35 ILCS 630/2 (1998 State Bar Edition). Subsection (a)(3) of Section 2 of the Act states that the term, "gross charge," which forms the basis for the tax, does not include "charges for leased time on equipment or charges for the storage of data or information for subsequent retrieval or the processing of data or information intended to change its form or content." Generally, persons that charge

subscribers for access to a specific internet web site and who do not, as part of that service, charge subscribers for the line or other transmission charges that are used to obtain access to the internet or that specific internet web site are not considered to be telecommunications retailers. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 495.100.

If Internet access service providers provide both transmission and data processing services, the charges for each must be disaggregated and separately identified. See 86 Ill. Adm. Code 495.100(c), enclosed. The statute does not require disaggregation on the customers' invoice, however. Therefore, it is the Department's position that so long as the non-telecommunications charges are disaggregated from the telecommunications charges in the retailers' books and records, for audit purposes, such disaggregation need not be shown on the customers' invoice. If the non-telecommunications charges are not disaggregated from the telecommunications charges, the full amount will be subject to Telecommunications Excise Tax. If none of the charges billed were for telecommunications, then none of the charges would be subject to tax.

Web page creation and design would be considered provision of a service. Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax. If tangible personal property is not transferred when providing a service, then no tax liability is incurred.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Since your company is located in New York, the following discussion regarding the principles of nexus may be helpful in determining your tax liability in Illinois. An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Cause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process

requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to Brown's Furniture, Inc. v. Zehnder, (1996), 171 Ill.2d 410.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis  
Associate Counsel

MAJ:msk  
Enc.